

AMEDISYS INC
Form 10-Q
October 26, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-Q

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2010

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission File Number: 0-24260

AMEDISYS, INC.

(Exact Name of Registrant as Specified in its Charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)
11-3131700
(I.R.S. Employer
Identification No.)
5959 S. Sherwood Forest Blvd., Baton Rouge, LA 70816
(Address of principal executive offices, including zip code)
(225) 292-2031 or (800) 467-2662
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒ Accelerated filer ☐
Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date, is as follows: Common stock, \$0.001 par value, 29,028,118 shares outstanding as of October 21, 2010.

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SPECIAL CAUTION CONCERNING FORWARD-LOOKING STATEMENTS AND AVAILABLE INFORMATION

Special Caution Concerning Forward-Looking Statements

When included in this Quarterly Report on Form 10-Q, or in other documents that we file with the Securities and Exchange Commission (SEC), or in statements made by or on behalf of our company, words like believes, belief, expects, plans, anticipates, intends, projects, estimates, may, might, would, should and similar expressions are intended to identify forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. These forward-looking statements involve a variety of risks and uncertainties that could cause actual results to differ materially from those described therein. These risks and uncertainties include, but are not limited to the following: changes in Medicare and other medical payment levels, our ability to open agencies, acquire additional agencies and integrate and operate these agencies effectively, changes in or our failure to comply with existing Federal and State laws or regulations or the inability to comply with new government regulations on a timely basis, competition in the home health industry, changes in the case mix of patients and payment methodologies, changes in estimates and judgments associated with critical accounting policies, our ability to maintain or establish new patient referral sources, our ability to attract and retain qualified personnel, changes in payments and covered services due to the economic downturn and deficit spending by Federal and State governments, future cost containment initiatives undertaken by third-party payors, our access to financing due to the volatility and disruption of the capital and credit markets, our ability to meet debt service requirements and comply with covenants in debt agreements, business disruptions due to natural disasters or acts of terrorism, our ability to integrate and manage our information systems, changes in or developments with respect to any litigation or investigations relating to the Company, including the United States Senate Committee on Finance inquiry, the SEC investigation and the U.S. Department of Justice Civil Investigative Demand and various other matters, many of which are beyond our control.

Because forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified, you should not rely on any forward-looking statement as a prediction of future events. We expressly disclaim any obligation or undertaking and we do not intend to release publicly any updates or changes in our expectations concerning the forward-looking statements or any changes in events, conditions or circumstances upon which any forward-looking statement may be based, except as required by law. For a discussion of some of the factors discussed above as well as additional factors, see our Annual Report on Form 10-K for the year ended December 31, 2009, filed with the SEC on February 23, 2010, particularly Part I, Item 1A. Risk Factors therein, which are incorporated herein by reference and Part II, Item 1A. Risk Factors of this Quarterly Report on Form 10-Q. Additional risk factors may also be described in reports that we file from time to time with the SEC.

Available Information

Our company website address is www.amedisys.com. We use our website as a channel of distribution for important company information. Important information, including press releases, analyst presentations and financial information regarding our company, is routinely posted on and accessible on the Investor Relations subpage of our website, which is accessible by clicking on the tab labeled Investors on our website home page. We also use our website to expedite public access to time-critical information regarding our company in advance of or in lieu of distributing a press release or a filing with the SEC disclosing the same information. Therefore, investors should look to the Investor Relations subpage of our website for important and time-critical information. Visitors to our website can also register to receive automatic e-mail and other notifications alerting them when new information is made available on the Investor Relations subpage of our website. In addition, we make available on the Investor Relations subpage of our website (under the link SEC filings) free of charge our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, ownership reports on Forms 3, 4 and 5 and any amendments to those reports as soon as practicable after we electronically file such reports with the SEC. Further, copies of our Certificate of Incorporation and Bylaws, our Code of Ethical Business Conduct, our Corporate Governance Guidelines and the charters for the Audit, Compensation, Quality of Care and Nominating and Corporate Governance Committees of our Board are also available on the Investor Relations subpage of our website (under the link Corporate Governance).

Additionally, our filings can be obtained at the SEC's Public Reference Room at 100 F Street, NE, Room 1580, Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at (800) SEC-0330. Our electronically filed reports can also be obtained on the SEC's internet site at <http://www.sec.gov>.

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****AMEDISYS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(Amounts in thousands, except share data)****(Unaudited)**

	September 30, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 128,037	\$ 34,485
Patient accounts receivable, net of allowance for doubtful accounts of \$23,036 and \$26,371	136,450	150,269
Prepaid expenses	9,932	10,279
Other current assets	7,838	23,003
Total current assets	282,257	218,036
Property and equipment, net of accumulated depreciation of \$75,954 and \$59,780	117,820	91,919
Goodwill	790,409	786,923
Intangible assets, net of accumulated amortization of \$15,972 and \$11,826	55,900	57,608
Other assets, net	17,536	17,865
Total assets	\$ 1,263,922	\$ 1,172,351
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	\$ 19,551	\$ 16,535
Payroll and employee benefits	117,200	119,619
Accrued expenses	33,746	33,035
Obligations due Medicare	4,618	4,618
Current portion of long-term obligations	39,265	44,254
Current portion of deferred income taxes	4,247	11,245
Total current liabilities	218,627	229,306
Long-term obligations, less current portion	153,414	170,899
Deferred income taxes	36,697	29,399
Other long-term obligations	6,963	6,412
Total liabilities	415,701	436,016
Commitments and Contingencies - Note 6		
Equity:		
Preferred stock, \$0.001 par value, 5,000,000 shares authorized; none issued or outstanding		
Common stock, \$0.001 par value, 60,000,000 shares authorized; 28,953,282 and 28,303,216 shares issued; and 28,318,915 and 28,191,174 shares outstanding	29	28

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Additional paid-in capital	398,133	363,670
Treasury stock at cost, 634,367 and 112,042 shares of common stock	(14,008)	(735)
Accumulated other comprehensive (loss) income	(10)	114
Retained earnings	462,571	372,089
Total Amedisys, Inc. stockholders' equity	846,715	735,166
Noncontrolling interests	1,506	1,169
Total equity	848,221	736,335
Total liabilities and equity	\$ 1,263,922	\$ 1,172,351

The accompanying notes are an integral part of these condensed consolidated financial statements.

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AMEDISYS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED INCOME STATEMENTS

(Amounts in thousands, except per share data)

(Unaudited)

	For the three-month periods ended September 30,		For the nine-month periods ended September 30,	
	2010	2009	2010	2009
Net service revenue	\$ 404,680	\$ 388,257	\$ 1,239,996	\$ 1,107,987
Cost of service, excluding depreciation and amortization	206,312	183,619	619,676	527,096
General and administrative expenses:				
Salaries and benefits	90,354	87,260	267,063	242,340
Non-cash compensation	2,636	820	8,317	5,740
Other	54,177	43,765	150,624	128,456
Provision for doubtful accounts	5,261	4,578	14,069	16,481
Depreciation and amortization	8,832	7,481	25,297	20,682
Operating expenses	367,572	327,523	1,085,046	940,795
Operating income	37,108	60,734	154,950	167,192
Other (expense) income:				
Interest income	197	28	374	161
Interest expense	(2,277)	(2,682)	(7,038)	(9,094)
Equity in earnings from unconsolidated joint ventures	788	655	2,310	1,721
Miscellaneous, net	(65)	324	(1,439)	978
Total other expense, net	(1,357)	(1,675)	(5,793)	(6,234)
Income before income taxes	35,751	59,059	149,157	160,958
Income tax expense	(13,943)	(23,033)	(58,153)	(62,774)
Net income	21,808	36,026	91,004	98,184
Net income attributable to noncontrolling interests	(174)	(86)	(522)	(140)
Net income attributable to Amedisys, Inc.	\$ 21,634	\$ 35,940	\$ 90,482	\$ 98,044
Net income per share attributable to Amedisys, Inc. common stockholders:				
Basic	\$ 0.77	\$ 1.31	\$ 3.23	\$ 3.62
Diluted	\$ 0.76	\$ 1.29	\$ 3.18	\$ 3.55
Weighted average shares outstanding:				
Basic	28,096	27,340	28,007	27,106
Diluted	28,499	27,912	28,490	27,615

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The accompanying notes are an integral part of these condensed consolidated financial statements.

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AMEDISYS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands)

(Unaudited)

	For the nine-month periods ended September 30,	
	2010	2009
Cash Flows from Operating Activities:		
Net income	\$ 91,004	\$ 98,184
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	25,297	20,682
Provision for doubtful accounts	14,069	16,481
Non-cash compensation	8,317	5,740
401(k) employer match	17,536	13,827
Loss on disposal of property and equipment	2,314	593
Deferred income taxes	300	11,677
Equity in earnings of unconsolidated joint ventures	(2,310)	(1,721)
Amortization of deferred debt issuance costs	1,182	1,182
Return on equity investment	1,390	625
Changes in operating assets and liabilities, net of impact of acquisitions:		
Patient accounts receivable	(250)	18,155
Other current assets	16,006	1,415
Other assets	(1,934)	1,930
Accounts payable	2,907	3,572
Accrued expenses	(3,771)	23,885
Other long-term obligations	551	2,695
Net cash provided by operating activities	172,608	218,922
Cash Flows from Investing Activities:		
Proceeds from sale of deferred compensation plan assets	2,425	956
Proceeds from the sale of property and equipment		41
Purchases of deferred compensation plan assets	(1,053)	(3,064)
Purchases of property and equipment	(37,535)	(25,998)
Acquisitions of businesses, net of cash acquired	(3,121)	(31,492)
Acquisitions of reacquired franchise rights	(2,376)	(5,214)
Net cash used in investing activities	(41,660)	(64,771)
Cash Flows from Financing Activities:		
Outstanding checks in excess of bank balance		(3,422)
Proceeds from issuance of stock upon exercise of stock options and warrants	1,494	966
Proceeds from issuance of stock to employee stock purchase plan	4,690	4,081
Tax benefit from stock option exercises	2,427	847
Non-controlling interest distribution	(185)	
Proceeds from revolving line of credit		50,200
Repayments of revolving line of credit		(130,700)
Purchase of company stock	(11,796)	

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Principal payments of long-term obligations	(34,026)	(33,810)
Net cash used in financing activities	(37,396)	(111,838)
Net increase in cash and cash equivalents	93,552	42,313
Cash and cash equivalents at beginning of period	34,485	2,847
Cash and cash equivalents at end of period	\$ 128,037	\$ 45,160
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest	\$ 7,949	\$ 9,885
Cash paid for income taxes, net of refunds received	\$ 49,870	\$ 47,135
Supplemental Disclosures of Non-Cash Financing and Investing Activities:		
Notes payable issued for acquisitions	\$ 750	\$ 8,455
Notes payable issued for software licenses	\$ 10,801	\$

The accompanying notes are an integral part of these condensed consolidated financial statements.

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AMEDISYS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. NATURE OF OPERATIONS, CONSOLIDATION AND PRESENTATION OF FINANCIAL STATEMENTS

Amedisys, Inc., a Delaware corporation, and its consolidated subsidiaries (Amedisys, we, us, or our) are a multi-state provider of home health and hospice services with approximately 85% and 88% of our revenue derived from Medicare for the three-month periods ended September 30, 2010 and 2009, respectively and approximately 86% and 88% of our revenue derived from Medicare for the nine-month periods ended September 30, 2010 and 2009, respectively. As of September 30, 2010, we had 537 Medicare-certified home health and 72 Medicare-certified hospice agencies in 45 states within the United States, the District of Columbia and Puerto Rico.

Basis of Presentation

In our opinion, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting solely of normal recurring adjustments) necessary to present fairly our financial position, our results of operations and our cash flows in accordance with U.S. generally accepted accounting principles (U.S. GAAP). Our results of operations for the interim periods presented are not necessarily indicative of results of our operations for the entire year and have not been audited by our independent auditors.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted from the interim financial information presented. This report should be read in conjunction with our consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2009 as filed with the Securities and Exchange Commission (SEC) on February 23, 2010 (the Form 10-K), which includes information and disclosures not included herein.

Use of Estimates

Our accounting and reporting policies conform with U.S. GAAP. In preparing the unaudited condensed consolidated financial statements, we are required to make estimates and assumptions that impact the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could materially differ from those estimates.

Reclassifications and Comparability

Certain reclassifications have been made to prior periods' financial statements in order to conform them to the current period's presentation.

As a result of our growth through acquisition and start-up activities, our operating results may not be comparable for the periods that are presented.

Principles of Consolidation

These unaudited condensed consolidated financial statements include the accounts of Amedisys, Inc. and our wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in our accompanying unaudited condensed consolidated financial statements, and business combinations accounted for as purchases have been included in our unaudited condensed consolidated financial statements from their respective dates of acquisition. In addition to our wholly owned subsidiaries, we also have certain equity investments that are accounted for as set forth below.

Equity Investments

We consolidate subsidiaries and/or joint ventures when the entity is a variable interest entity and we are the primary beneficiary or if we have controlling interests in the entity, which is generally ownership in excess of 50%. Third party equity interests in our consolidated joint ventures are reflected as noncontrolling interests in our condensed consolidated financial statements.

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For subsidiaries or joint ventures in which we do not have a controlling interest or for which we are not the primary beneficiary, we record such investments under the equity method of accounting.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Revenue Recognition

We earn net service revenue through our home health and hospice agencies by providing a variety of services almost exclusively in the homes of our patients. This net service revenue is earned and billed either on an episode of care basis (on a 60-day episode of care basis for home health services and on a 90-day episode of care basis for the first two hospice episodes of care and on a 60-day episode of care basis for any subsequent hospice episodes), on a per visit basis or on a daily basis depending upon the payment terms and conditions established with each payor for services provided. We refer to home health revenue earned and billed on a 60-day episode of care as episodic-based revenue. For the services we provide, Medicare is our largest payor.

When we record our service revenue, we record it net of estimated revenue adjustments and contractual adjustments to reflect amounts we estimate to be realizable for services provided, as discussed below. We believe, based on information currently available to us and based on our judgment, that changes to one or more factors that impact the accounting estimates (such as our estimates related to revenue adjustments, contractual adjustments and episodes in progress) we make in determining net service revenue, which changes are likely to occur from period to period, will not materially impact our reported consolidated financial condition, results of operations, cash flows or our future financial results.

Home Health Revenue Recognition

Medicare Revenue

Net service revenue is recorded under the Medicare payment program (PPS) based on a 60-day episode payment rate that is subject to adjustment based on certain variables including, but not limited to: (a) an outlier payment if our patient's care was unusually costly (capped at 10% of total reimbursement); (b) a low utilization payment adjustment (LUPA) if the number of visits was fewer than five; (c) a partial payment if our patient transferred to another provider or we received a patient from another provider before completing the episode; (d) a payment adjustment based upon the level of therapy services required (thresholds set at 6, 14 and 20 visits); (e) the number of episodes of care provided to a patient, regardless of whether the same home health provider provided care for the entire series of episodes; (f) changes in the base episode payments established by the Medicare Program; (g) adjustments to the base episode payments for case mix and geographic wages; and (h) recoveries of overpayments.

We make adjustments to Medicare revenue on completed episodes to reflect differences between estimated and actual payment amounts, an inability to obtain appropriate billing documentation or authorizations acceptable to the payor and other reasons unrelated to credit risk. We estimate the impact of such adjustments based on our historical experience, which primarily includes a historical collection rate of over 99% on Medicare claims, and record this estimate during the period in which services are rendered as an estimated revenue adjustment and a corresponding reduction to patient accounts receivable. Therefore, we believe that our reported net service revenue and patient accounts receivable will be the net amounts to be realized from Medicare for services rendered.

In addition to revenue recognized on completed episodes, we also recognize a portion of revenue associated with episodes in progress. Episodes in progress are 60-day episodes of care that begin during the reporting period, but were not completed as of the end of the period. We estimate this revenue on a monthly basis based upon historical trends. The primary factors underlying this estimate are the number of episodes in progress at the end of the reporting period, expected Medicare revenue per episode and our estimate of the average percentage complete based on visits performed. As of September 30, 2010 and 2009, the difference between the cash received from Medicare for a request for anticipated payment (RAP) on episodes in progress and the associated estimated revenue was immaterial and therefore the resulting credits were recorded as a reduction to our outstanding patient accounts receivable in our condensed consolidated balance sheets for such periods.

Non-Medicare Revenue

Episodic-based Revenue. We recognize revenue in a similar manner as we recognize Medicare revenue for episodic-based rates that are paid by other insurance carriers, including Medicare Advantage programs; however, these rates can vary based upon the negotiated terms.

Non-episodic Based Revenue. Gross revenue is recorded on an accrual basis based upon the date of service at amounts equal to our established or estimated per-visit rates, as applicable. Contractual adjustments are recorded for the difference between our standard rates and the contracted rates to be realized from patients, third parties and others for services provided and are deducted from gross revenue to determine net service revenue and are also recorded as a reduction to our outstanding patient accounts receivable. In addition, we receive a minimal amount of our net service revenue from patients who are either self-insured or are obligated for an insurance co-payment.

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Hospice Revenue Recognition

Hospice Medicare Revenue

Gross revenue is recorded on an accrual basis based upon the date of service at amounts equal to the estimated payment rates. The estimated payment rates are daily or hourly rates for each of the four levels of care we deliver. The four main levels of care we provide are routine care, general inpatient care, continuous home care and respite care. Routine care accounts for 97% of our hospice Medicare revenue for the three and nine-month periods ended September 30, 2010 and 2009. We make adjustments to Medicare revenue for an inability to obtain appropriate billing documentation or authorizations acceptable to the payor and other reasons unrelated to credit risk. We estimate the impact of these adjustments based on our historical experience, which primarily includes our historical collection rate on Medicare claims, and record it during the period services are rendered as an estimated revenue adjustment and as a reduction to our outstanding patient accounts receivable.

Additionally, as Medicare hospice revenue is subject to an inpatient cap limit and an overall payment cap, we monitor our provider numbers and estimate amounts due back to Medicare if a cap has been exceeded. We record these adjustments as a reduction to revenue and to an increase in other accrued liabilities. As of September 30, 2010 and December 31, 2009, we had \$1.8 million and \$0.1 million, respectively, recorded for estimated amounts due back to Medicare in other accrued liabilities in our accompanying condensed consolidated balance sheets. As a result of our adjustments, we believe our revenue and patients accounts receivable are recorded at amounts that will be ultimately realized.

Hospice Non-Medicare Revenue

We record gross revenue on an accrual basis based upon the date of service at amounts equal to our established rates or estimated per visit rates, as applicable. Contractual adjustments are recorded for the difference between our established rates and the amounts estimated to be realizable from patients, third parties and others for services provided and are deducted from gross revenue to determine our net service revenue and patient accounts receivable.

Patient Accounts Receivable

Our patient accounts receivable are uncollateralized and consist of amounts due from Medicare, Medicaid, other third-party payors and patients. We believe there is a certain level of credit risk associated with non-Medicare payors. To provide for our non-Medicare patient accounts receivable that could become uncollectible in the future, we establish an allowance for doubtful accounts to reduce the carrying amount to its estimated net realizable value. We believe the credit risk associated with our Medicare accounts, which represent 72% and 77% of our net patient accounts receivable at September 30, 2010 and December 31, 2009, respectively, is limited due to (i) our historical collection rate of over 99% from Medicare and (ii) the fact that Medicare is a U.S. government payor. Accordingly, we do not record an allowance for doubtful accounts for our Medicare patient accounts receivable, which are recorded at their net realizable value after recording estimated revenue adjustments as discussed above. During the three and nine-month periods ended September 30, 2010, we recorded \$2.7 million and \$4.4 million, respectively, in estimated revenue adjustments to Medicare revenue as compared to \$1.9 million and \$5.9 million during the three and nine-month periods ended September 30, 2009, respectively. There is no other single payor, other than Medicare, that accounts for more than 10% of our total outstanding patient receivables, and thus we believe there are no other significant concentrations of receivables that would subject us to any significant credit risk in the collection of our patient accounts receivable.

We fully reserve for accounts which are aged at 360 days or greater. We write off accounts on a monthly basis once we have exhausted our collection efforts and deem an account to be uncollectible.

Medicare Home Health

For our home health patients, our pre-billing process includes verifying that we are eligible for payment from Medicare for the services that we provide to our patients. Our Medicare billing begins with a process to ensure that our billings are accurate through the utilization of an electronic Medicare claim review. We submit a RAP for 60% of our estimated payment for the initial episode at the start of care or 50% of the estimated payment for any subsequent episodes of care contiguous with the first episode for a particular patient. The full amount of the episode is billed after the episode has been completed (final billed). The RAP received for that particular episode is then deducted from our final payment. If a final bill is not submitted within the greater of 120 days from the start of the episode, or 60 days from the date the RAP was paid, any RAPs received for that episode will be recouped by Medicare from any other claims in process for that particular provider number. The RAP and final claim must then be re-submitted.

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Medicare Hospice

For our hospice patients, our pre-billing process includes verifying that we are eligible for payment from Medicare for the services that we provide to our patients. Once each patient has been confirmed for eligibility, we will bill Medicare on a monthly basis for the services provided to the patient.

Non-Medicare Home Health and Hospice

For our non-Medicare patients, our pre-billing process primarily begins with verifying a patient's eligibility for services with the applicable payor. Once the patient has been confirmed for eligibility, we will provide services to the patient and bill the applicable payor. We estimate an allowance for doubtful accounts to reduce the carrying amount of the receivables to the amounts we estimate will be ultimately collected. Our review and evaluation of non-Medicare accounts receivable includes a detailed review of outstanding balances and special consideration to concentrations of receivables from particular payors or groups of payors with similar characteristics that would subject us to any significant credit risk. In addition, the amount of the allowance for doubtful accounts is based upon our assessment of historical and expected net collections, business and economic conditions, trends in payment and an evaluation of collectibility based upon the date that the service was provided. Based upon our best judgment, we believe the allowance for doubtful accounts adequately provides for accounts that will not be collected due to credit risk.

Fair Value of Financial Instruments

The following details our financial instruments where the carrying value and fair value differ (amounts in millions):

Financial Instrument	Fair Value at Reporting Date Using			
	Quoted Prices in			
	Active Markets for			
As of September 30, 2010	Identical Items			Significant Unobservable Inputs (Level 3)
	Level 1	Level 2	Level 3	
Long-term obligations, excluding capital leases	\$ 192.6	\$ 191.1	\$	

The estimates of the fair value of our long-term obligations are based upon a discounted present value analysis of future cash flows. Due to the existing uncertainty in the capital and credit markets, the actual rates that would be obtained to borrow under similar conditions could materially differ from the estimates we have used.

The fair value hierarchy is based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value. The three levels of inputs are as follows:

Level 1 Quoted prices in active markets for identical assets and liabilities.

Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities.

For our other financial instruments, including our cash and cash equivalents, patient accounts receivable, accounts payable and accrued expenses, we estimate the carrying amounts approximate fair value due to their short term maturity. Our deferred compensation plan assets are

recorded at fair value.

Weighted-Average Shares Outstanding

Net income per share attributable to Amedisys, Inc. common stockholders, calculated on the treasury stock method, is based on the weighted average number of shares outstanding during the period. The following table sets forth, for the periods indicated, shares used in our computation of the weighted-average shares outstanding, which are used to calculate our basic and diluted net income per share attributable to Amedisys, Inc. common stockholders (amounts in thousands):

	For the three-month periods ended September 30,		For the nine-month periods ended September 30,	
	2010	2009	2010	2009
Weighted average number of shares outstanding - basic	28,096	27,340	28,007	27,106
Effect of dilutive securities:				
Stock options	79	201	143	208
Non-vested stock and stock units	324	371	340	301
Weighted average number of shares outstanding - diluted	28,499	27,912	28,490	27,615

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For the three and nine-month periods ended September 30, 2010, there were 161,726 and 69,629 shares, respectively, of additional securities that were anti-dilutive compared to 1,209 and 3,848 shares for the three and nine-month periods ended September 30, 2009, respectively.

3. ACQUISITIONS

We complete acquisitions from time to time in order to pursue our strategy of increasing our market presence by expanding our service base and enhancing our position in certain geographic areas as a leading provider of home health and hospice services. The purchase price paid for acquisitions is negotiated through arm's length transactions, with consideration based on our analysis of, among other things, comparable acquisitions and expected cash flows for each transaction. Acquisitions are accounted for as purchases and are included in our condensed consolidated financial statements from their respective acquisition dates. Goodwill generated from acquisitions is recognized for the excess of the purchase price over tangible and identifiable intangible assets because of the expected contributions of the acquisitions to our overall corporate strategy.

2010 Acquisitions

On February 1, 2010, we acquired certain assets and liabilities of a home health agency in DeQueen, Arkansas for a total purchase price of \$2.5 million (\$2.0 million in cash and a \$0.5 million promissory note). In connection with the acquisition, we recorded substantially the entire purchase price as goodwill (\$2.2 million) and other intangibles (\$0.3 million).

On April 5, 2010, we acquired certain assets and liabilities of a hospice agency in Killen, Alabama for a total purchase price of \$1.0 million (\$0.7 million in cash and a \$0.3 million promissory note). In connection with the acquisition, we recorded substantially the entire purchase price as goodwill (\$1.1 million), other intangibles (\$0.1 million) and other liabilities (\$0.2 million).

On July 1, 2010, we acquired certain assets and liabilities of a home health agency in Buckeye, West Virginia for a total purchase price of \$0.4 million (\$0.4 million in cash). In connection with the acquisition, we recorded substantially the entire purchase price as goodwill (\$0.2 million) and other intangibles (\$0.2 million).

4. GOODWILL AND OTHER INTANGIBLE ASSETS, NET

The following table summarizes the activity related to our goodwill and our other intangible assets, net, as of and for the nine-month period ended September 30, 2010 (amounts in millions):

	Home Health	Goodwill Hospice	Total
Balances at December 31, 2009	\$ 719.9	\$ 67.0	\$ 786.9
Additions	2.4	1.1	3.5
Balances at September 30, 2010	\$ 722.3	\$ 68.1	\$ 790.4

	Certificates of Need and Licenses	Other Intangible Assets, Net Acquired Names of Business (1)	Non-Compete Agreements & Reacquired Franchise Rights (2)	Total
Balances at December 31, 2009	43.4	4.7	9.5	57.6
Additions	0.5	0.1	2.7	3.3
Write-off	(0.9)			(0.9)
Amortization		(0.1)	(4.0)	(4.1)

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Balances at September 30, 2010	\$ 43.0	\$ 4.7	\$ 8.2	\$ 55.9
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- (1) Acquired Names of Business includes \$4.4 million of unamortized acquired names and \$0.3 million of amortized acquired names which have a weighted-average amortization period of 2.7 years.
- (2) The weighted-average amortization period of our non-compete agreements and reacquired franchise rights is 2.8 and 2.4 years, respectively.

During the three-month period ended September 30, 2010, we wrote-off \$0.9 million in Medicare licenses related to the closing/mergers of the agencies discussed in Note 8.

Table of Contents**5. LONG-TERM OBLIGATIONS**

Long-term obligations, including capital lease obligations, consisted of the following for the periods indicated (amounts in millions):

	September 30, 2010	December 31, 2009
Senior Notes:		
\$35.0 million Series A Notes; semi-annual interest only payments; interest rate at 6.07% per annum; due March 25, 2013	\$ 35.0	\$ 35.0
\$30.0 million Series B Notes; semi-annual interest only payments; interest rate at 6.28% per annum; due March 25, 2014	30.0	30.0
\$35.0 million Series C Notes; semi-annual interest only payments; interest rate at 6.49% per annum; due March 25, 2015	35.0	35.0
\$150.0 million Term Loan; \$7.5 million principal payments plus accrued interest payable quarterly; interest rate at ABR Rate plus applicable percentage or Eurodollar Rate plus the applicable percentage (1.02% at September 30, 2010); due March 26, 2013	75.0	97.5
Promissory notes	17.6	17.6
Capital leases		0.1
	192.6	215.2
Current portion of long-term obligations	(39.2)	(44.3)
Total	\$ 153.4	\$ 170.9

Our weighted-average interest rate for our five year Term Loan for the three and nine-month periods ended September 30, 2010 was 1.1% as compared to 1.3% and 1.8% for the three and nine-month periods ended September 30, 2009, respectively.

As of September 30, 2010, our total leverage ratio (used to compute the margin and commitment fees, described in more detail in Note 6 of the financial statements included in our Form 10-K) was 0.7 and our fixed charge coverage ratio was 1.9.

As of September 30, 2010, our availability under our \$250.0 million Revolving Credit Facility was \$234.6 million as we had \$15.4 million outstanding in letters of credit.

See Note 6 of the financial statements included in our Form 10-K for additional details on our outstanding long-term obligations.

6. COMMITMENTS AND CONTINGENCIES***Legal Proceedings***

In addition to the matters referenced in this note, we are involved in legal actions in the normal course of business, some of which seek monetary damages, including claims for punitive damages. We do not believe that these normal course actions, when finally concluded and determined, will have a material impact on our consolidated financial condition, results of operations or cash flows. We are also involved in the legal actions set forth below.

United States Senate Committee on Finance Inquiry

On May 12, 2010, we received a letter of inquiry from the United States Senate Committee on Finance requesting documents and information relating to our policies and practices regarding home therapy visits and therapy utilization trends. A similar letter was sent to the other major publicly traded home healthcare companies. We intend to cooperate with the Committee with respect to this inquiry. No assurances can be given

as to the timing of this inquiry or as to the outcome of this inquiry.

Securities Class Action Lawsuits

On June 7, 2010, a putative securities class action complaint was filed in the United States District Court for the Middle District of Louisiana on behalf of all persons who purchased Amedisys securities between February 23, 2010 and May 13, 2010 against the Company and certain of our senior executives alleging violations of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 thereunder. The complaint alleges that we and certain of our senior executives made false and/or misleading statements, as well as failed to disclose material facts, about our business, financial condition, operations and prospects, particularly relating to our policies and practices regarding home therapy visits under the Medicare home health prospective payment system and the related alleged impact on our business, financial condition, operations and prospects. The complaint seeks a determination that the action may be maintained as a class action, an award of unspecified monetary damages and other unspecified relief. No assurances can be given as to the timing or outcome of this complaint.

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Additional putative securities class actions were filed in the United States District Court for the Middle District of Louisiana on July 14, July 16, and July 28, 2010. Those actions make allegations similar those included in the June 7, 2010 complaint described above, except that each purports to assert claims on behalf of a different putative class of purchasers of Amedisys securities.

Derivative Actions

On July 2, 2010, an alleged shareholder of the Company filed a derivative lawsuit in the United States District Court for the Middle District of Louisiana, purporting to assert claims on behalf of the Company against certain of our officers and directors. We are named as a nominal defendant in the action. The complaint alleges that our officers and directors breached their fiduciary duties to the Company by making allegedly false statements, and by allegedly failing to establish sufficient internal controls over certain of our home health and Medicare billing practices. The complaint seeks an unspecified amount of damages and an order directing the Company to adopt certain measures purportedly designed to improve its corporate governance and internal procedures. Three similar derivative suits were filed in the United States District Court for the Middle District of Louisiana on July 15, July 21, and August 2, 2010. No assurances can be given as to the timing or outcome of this lawsuit.

On July 23, 2010, a derivative suit was filed in the Nineteenth Judicial District Court, Parish of East Baton Rouge, State of Louisiana. That action also purports to assert claims on behalf of the Company against certain of our officers and directors, and seeks an unspecified amount of damages and an order directing the Company to adopt unspecified measures to improve its corporate governance and internal procedures. No assurances can be given as to the timing or outcome of this lawsuit.

ERISA Class Action Lawsuit

On September 27, 2010, a putative class action complaint was filed in the United States District Court for the Middle District of Louisiana against us, certain of our senior executives and current and certain former members of our 401(k) Plan Administrative Committee. The suit alleges violations of the Employee Retirement Income Security Act (ERISA) since January 1, 2006. The plaintiff brought the complaint on behalf of herself and a class of similarly situated participants in our 401(k) plan. The plaintiff asserts that the defendants breached their fiduciary duties to the 401(k) Plan s participants by causing the 401(k) plan to offer and hold Amedisys common stock during the class period when it was an allegedly unduly risky and imprudent retirement investment because of our alleged improper business practices. The complaint seeks a determination that the action may be maintained as a class action, an award of unspecified monetary damages and other unspecified relief. No assurances can be given as to the timing or outcome of this complaint.

SEC Investigation

On June 30, 2010, we received notice of a formal investigation from the SEC and received a subpoena for documents relating to the matters under review by the United States Senate Committee on Finance and other matters involving our operations. We intend to cooperate with the SEC with respect to this investigation. No assurances can be given as to the timing or outcome of this investigation.

U.S. Department of Justice Civil Investigative Demand (CID)

On September 27, 2010, we received a CID issued by the U.S. Department of Justice pursuant to the federal False Claims Act. The CID requires the delivery of a wide range of documents and information to the United States Attorney s Office for the Northern District of Alabama, relating to the Company s clinical and business operations, including reimbursement and billing claims submitted to Medicare for home health services, and related compliance activities. The CID generally covers the period from January 1, 2003. We intend to cooperate with the Department of Justice with respect to this investigation. No assurance can be given as to the timing or outcome of this investigation.

We are unable to assess the probable outcome or potential liability, if any, arising from the United States Senate Committee on Finance inquiry, the SEC investigation, the U.S. Department of Justice CID or the related litigation described above given the preliminary stage of these matters.

We recognize that additional putative securities class action complaints and other litigation could be filed, and that other investigations and actions could be commenced, relating to matters involving our home therapy visits and therapy utilization trends or other matters.

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Insurance

We are obligated for certain costs associated with our insurance programs, including employee health, workers' compensation and professional liability. While we maintain various insurance programs to cover these risks, we are self-insured for a substantial portion of our potential claims. We recognize our obligations associated with these costs in the period in which a claim is incurred, including with respect to both reported claims and claims incurred but not reported, up to specified deductible limits. These costs have generally been estimated based on historical data of our claims experience. Such estimates, and the resulting reserves, are reviewed and updated by us on a quarterly basis.

Our health insurance has a retention limit of \$0.5 million, our workers' compensation insurance has a retention limit of \$0.4 million and our professional liability insurance has a retention limit of \$0.3 million.

7. SHARE REPURCHASE PROGRAM

On August 6, 2010, our Board of Directors authorized a stock repurchase program of up to \$60.0 million of our common stock. Purchases may be made through open market and privately negotiated transactions, at times and in such amounts as management deems appropriate, including pursuant to one or more Rule 10b5-1 trading plans. The share repurchase program is scheduled to expire on September 30, 2011.

The timing of any repurchases and the actual number of shares repurchased will depend on a variety of factors, including the price of our common stock, corporate and regulatory requirements, restrictions under our debt obligations and other market and economic conditions. The stock repurchase program does not obligate Amedisys to acquire any particular amount of common stock and may be modified, suspended or discontinued at any time.

During the three months ended September 30, 2010, pursuant to this program, we repurchased 495,815 shares of our common stock at a weighted average price of \$23.79 per share and a total cost of approximately \$11.8 million. The repurchased shares are classified as treasury shares.

8. EXIT ACTIVITIES

In September 2010, we announced plans to close nine home health agencies and four hospice agencies, consolidate another 23 home health agencies and three hospice agencies into existing locations and discontinue the start-up process associated with 28 prospective home health agencies. In addition to these 67 agencies, we have closed or consolidated an additional 17 home health agencies during the first and second quarters of 2010.

As part of our exit activities associated with these locations, we recorded \$5.6 million and \$7.1 million in lease liabilities associated with future lease obligations during the three and nine-month period ended September 30, 2010, respectively and recorded \$0.4 million in severance costs and \$0.9 million for intangible write-offs during the three and nine-month periods ended September 30, 2010. We expect to complete these actions by the end of the fourth quarter of 2010 and incur approximately \$2.0 million in additional costs related to these exit activities. However, as a part of our ongoing normal operational review, we may, from time to time, close or consolidate additional agencies.

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Our operations involve servicing patients through our two reportable business segments: home health and hospice. Our home health segment delivers a wide range of services in the home of individuals who may be recovering from surgery, have a chronic disability or terminal illness or need assistance with the essential activities of daily living. Our hospice segment provides palliative care and comfort to terminally ill patients and their families. The other column in the following tables consists of costs relating to corporate support functions that are not directly attributable to a specific segment.

Management evaluates performance and allocates resources based on the operating income of the reportable segments, which exclude corporate expenses, but includes revenues and all other costs directly attributable to the specific segment. Segment assets are not reviewed by the company's chief operating decision maker and therefore are not disclosed below. The following table summarizes our segment information for the periods indicated (amounts in millions):

	For the Three-Month Period Ended September 30, 2010			
	Home Health	Hospice	Other	Total
Net service revenue	\$ 368.5	\$ 36.2	\$	\$ 404.7
Cost of service, excluding depreciation and amortization	186.2	20.1		206.3
General and administrative expenses	92.0	9.4	45.8	147.2
Provision for doubtful accounts	5.1	0.2		5.3
Depreciation and amortization	3.8	0.1	4.9	8.8
Operating expenses	287.1	29.8	50.7	367.6
Operating income	\$ 81.4	\$ 6.4	\$ (50.7)	\$ 37.1

	For the Three-Month Period Ended September 30, 2009			
	Home Health	Hospice	Other	Total
Net service revenue	\$ 359.4	\$ 28.9	\$	\$ 388.3
Cost of service, excluding depreciation and amortization	168.7	14.9		183.6
General and administrative expenses	79.8	6.7	45.3	131.8
Provision for doubtful accounts	4.1	0.5		4.6
Depreciation and amortization	3.5	0.3	3.7	7.5
Operating expenses	256.1	22.4	49.0	327.5
Operating income	\$ 103.3	\$ 6.5	\$ (49.0)	\$ 60.8

	For the Nine-Month Period Ended September 30, 2010			
	Home Health	Hospice	Other	Total
Net service revenue	\$ 1,137.0	\$ 103.0	\$	\$ 1,240.0
Cost of service, excluding depreciation and amortization	563.9	55.8		619.7
General and administrative expenses	269.4	25.1	131.5	426.0
Provision for doubtful accounts	12.9	1.2		14.1
Depreciation and amortization	11.3	0.4	13.6	25.3
Operating expenses	857.5	82.5	145.1	1,085.1

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Operating income	\$ 279.5	\$ 20.5	\$ (145.1)	\$ 154.9
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	For the Nine-Month Period Ended September 30, 2009			
	Home Health	Hospice	Other	Total
Net service revenue	\$ 1,035.6	\$ 72.4	\$	\$ 1,108.0
Cost of service, excluding depreciation and amortization	488.5	38.5		527.0
General and administrative expenses	229.7	17.4	129.5	376.6
Provision for doubtful accounts	15.4	1.1		16.5
Depreciation and amortization	10.0	0.7	10.0	20.7
Operating expenses	743.6	57.7	139.5	940.8
Operating income	\$ 292.0	\$ 14.7	\$ (139.5)	\$ 167.2

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis provides information we believe is relevant to an assessment and understanding of our results of operations and financial condition for the three and nine-month periods ended September 30, 2010. This discussion should be read in conjunction with the condensed consolidated financial statements and notes thereto included herein, and the consolidated financial statements and notes and the related Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2009 filed with the Securities and Exchange Commission (SEC) on February 23, 2010 (the Form 10-K), which are incorporated herein by this reference.

Unless otherwise provided, Amedisys, we, us, our and the Company refer to Amedisys, Inc. and our consolidated subsidiaries.

Overview

We are a leading provider of high-quality, low-cost home health services to the chronic, co-morbid, aging American population. Our services include home health and hospice services, and approximately 85% and 88% of our revenue was derived from Medicare for the three-month periods ended September 30, 2010 and 2009, respectively, and approximately 86% and 88% of our revenue was derived from Medicare for the nine-month periods ended September 30, 2010 and 2009, respectively. During the three-month period ended September 30, 2010, we had \$404.7 million in net service revenue, earnings per diluted share of \$0.76 and cash flow from operations of \$47.2 million. For the nine-month period ended September 30, 2010, we had \$1.2 billion in net service revenue, earnings per diluted share of \$3.18 and cash flow from operations of \$172.6 million.

During the three-month period ended September 30, 2010, we incurred certain costs associated with the realignment of operations including severance and legal expenses related to the United States Senate Committee on Finance inquiry and SEC investigation discussed in Note 6 to the condensed consolidated financial statements. In addition, for the nine-month period ended September 30, 2010 certain costs include the reversal of accrued bonuses during the second quarter of 2010. We also incurred costs associated with our exit activities for the three-and nine month periods ended September 30, 2010, discussed in Note 8 to the condensed consolidated financial statements. During the three-month period ended September 30, 2010 we settled our Georgia indigent care liability for the years 2007 through 2009 and during the three-month period June 30, 2010 we received the Centers for Medicare and Medicaid Services (CMS) bonus payments as the result of the pay for performance demonstration. The following details these items for the three and nine-month periods ended September 30, 2010:

	For the three-month periods ended September 30, 2010			For the nine-month periods ended September 30, 2010		
	(Income) Expense	Net of tax	EPS	(Income) Expense	Net of tax	EPS
Georgia indigent care liability	\$ (3.7)	\$ (2.2)	\$ (0.08)	\$ (3.7)	\$ (2.2)	\$ (0.08)
CMS bonus payment				(3.6)	(2.2)	(0.08)
Exit activities	6.9	4.2	0.15	8.4	5.1	0.18
Certain costs	3.1	1.8	0.06	6.4	3.9	0.14
Total	\$ 6.3	\$ 3.8	\$ 0.13	\$ 7.5	\$ 4.6	\$ 0.16

Exit Activities

During September, we announced plans to consolidate 23 operating home health agencies and three hospice agencies (of which four home health agencies were consolidated as of September 2010) with agencies servicing the same markets, close nine operating home health agencies and four operating hospice agencies (of which one hospice agency was closed as of September 2010) and discontinue the start-up process associated with 28 prospective unopened home health locations (of which 17 were discontinued as of September 2010) which were incurring expenses.

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In addition to these 67 agencies we have closed or consolidated an additional 17 home health agencies during the first and second quarters of 2010. As part of our exit activities associated with these locations, we recorded \$5.6 million and \$7.1 million in lease liabilities during the three and nine-month period ended September 30, 2010 associated with future lease obligations and recorded \$0.4 million in severance costs and \$0.9 million for intangible write-offs during the three and nine month periods ended September 30, 2010. The following details the financial performance of the agencies that we are exiting or consolidating:

	For the three-month period ended September 30, 2010		For the nine-month period ended September 30, 2010	
	Net Service Revenue	Operating loss(1)	Net Service Revenue	Operating loss(1)
Home Health:				
Closures	\$ 1.1	\$ (0.5)	\$ 3.9	\$ (2.1)
Consolidations	4.6	(0.9)	18.4	(3.5)
Unopened Startups		(1.9)		(5.1)
Home Health Total	5.7	(3.3)	22.3	(10.7)
Hospice:				
Closures	\$ 0.4	\$ (0.2)	\$ 1.3	\$ (0.3)
Consolidations	0.7	0.1	2.0	(0.2)
Unopened Startups		(0.1)		(0.4)
Hospice Total	1.1	(0.2)	3.3	(0.9)
Total	\$ 6.7	\$ (3.5)	\$ 25.6	\$ (11.6)

(1) Excludes the \$6.9 million and \$8.4 million in exit activity costs for the three and nine-month periods ended September 30, 2010, respectively

The following table summarizes our Medicare-certified agencies, which are located in 45 states within the United States, the District of Columbia and Puerto Rico as of September 30, 2010.

	Owned and Operated Agencies	
	Home health	Hospice
At December 31, 2009	521	65
Acquisitions	2	1
Start-ups	35	7
Closed/Consolidated	(21)	(1)
At September 30, 2010	537	72

Recent Developments

Health Care Reform

In March 2010, President Obama signed into law the Patient Protection and Affordable Care Act (PPACA) and the Health Care and Education Reconciliation Act of 2010 (HCERA), which amends the PPACA (collectively, the Health Care Reform Bills). The Health Care Reform Bills

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make a number of changes to Medicare payment rates, including the reinstatement of the 3% home health rural add-on which began on April 1, 2010 (expiring January 1, 2016), and CMS has recently proposed several changes to Medicare home health payments for 2011, as discussed below.

The Health Care Reform Bills also include a systemic rebasing of the amount CMS reimburses for home health services, to be phased in over four years, beginning in 2014. We anticipate that many of the provisions of the Health Care Reform Bills may be subject to further clarification and modification through the rule-making process. It is uncertain at this time the effect the rebasing will have on our future results of operations or cash flows.

Additionally, the Health Care Reform Bills expand health care coverage to many uninsured individuals and expand coverage to those already insured. We do not expect any short term impact on our financial results as a result of these aspects of the legislation. One provision that will impact certain companies significantly is the elimination of the tax deductibility of the Medicare Part D subsidy. This provision does not affect us as we do not provide retiree health benefits.

Payment

In July 2010, CMS issued a proposed rule to update and revise Medicare home health rates for calendar year 2011. The proposed rule includes the following changes to the base rate: a 1.4% market basket increase which includes the 1% reduction mandated by the Health Care Reform Bills, a negative 3.79% case-mix adjustment and a 2.5% reduction to reflect the elimination of the increase in the base reimbursement rate resulting from the outlier cap introduced in 2010. The net effect of these changes decreases the base rate for 2011 by 4.9% to \$2,199. CMS has not issued a final rule as of the date of this filing. The final rule is expected to be published in October 2010.

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In July 2010, CMS issued a notice with comment period to update and revise the Medicare hospice wage index for fiscal year 2011. The notice includes a 2.6% increase in the base rate offset by a 0.8% decrease for the updated wage index data and the second year of the 7-year phase out of the budget neutrality adjustment factor. The net effect of the changes increases the base rate for 2011 by 1.8%. The notice is effective October 1, 2010. We do not expect this change to have a material impact on our future results of operations or financial condition.

Results of Operations

Our operating results may not be comparable for the periods presented, primarily as a result of our acquisition and start-up agencies.

When we refer to base business, we mean home health and hospice agencies that we have operated for at least the last twelve months; when we refer to acquisitions, we mean home health and hospice agencies that we acquired within the last twelve months; and when we refer to start-ups, we mean any home health or hospice agency opened by us in the last twelve months. Once an agency has been in operation for a twelve month period, the results for that particular agency are included as part of our base business from that date forward. When we refer to episodic-based revenue, admissions, recertifications or completed episodes, we are referring only to data for payors that pay on an episodic-basis, which includes Medicare and other insurance carriers, including Medicare Advantage programs.

Three-Month Period Ended September 30, 2010 Compared to the Three-Month Period Ended September 30, 2009**Net Service Revenue**

The following table summarizes our net service revenue growth (amounts in millions):

		For the three-month periods ended September 30,			
		2010		2009	
		Base/Start-ups (2)	Acquisitions	Total	Total Variance
Home health revenue:					
(442					) \$ (595)
Three Months 2015	Marketable Securities	Pension Plans	Hedges	Financial Statement Translation	Total
Beginning	\$ 4	\$(123)	\$ 14	\$ (416)	\$(521)
OCI	(3)	(6)	22	87	100
Tax expense (benefit)	—	1	(8)	—	(7)
Reclassifications to:					
Cost of sales	—	2	(6)	—	(4)
Other income	(2)	—	—	—	(2)
Income tax expense (benefit)	1	—	2	—	3
Net OCI	(4)	(3)	10	87	90
Ending	\$ —	\$(126)	\$ 24	\$ (329)	\$(431)
Six Months 2016	Marketable Securities	Pension Plans	Hedges	Financial Statement Translation	Total
Beginning	\$ —	\$(119)	\$ 4	\$ (524)	\$(639)
OCI	2	(6)	(40)	77	33
Tax expense (benefit)	(1)	1	11	5	16
Reclassifications to:					

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Cost of sales	—	3	(8)—	(5)
Other income	(2)	—	—	(2)
Income tax expense (benefit)	1	(1)2	—	2	
Net OCI	—	(3)	(35)82	44
Ending	\$	—	\$ (122	)\$ (31	)\$ (442	)\$ (595)

Six Months 2015	Marketable Securities	Pension Plans	Financial Hedges	Statement Translation	Total
Beginning	\$ 3	\$ (136)	\$ 13	\$ (134)	\$ (254)
OCI	1	9	21	(195)	(164)
Tax expense (benefit)	(1)	(2)	(6)	—	(9)
Reclassifications to:					
Cost of sales	—	4	(6)	—	(2)
Other income	(4)	—	—	—	(4)
Income tax expense (benefit)	1	(1)	2	—	2
Net OCI	(3)	10	11	(195)	(177)
Ending	\$ —	\$ (126)	\$ 24	\$ (329)	\$ (431)

NOTE 4 - DERIVATIVE INSTRUMENTS

We use operational and economic hedges, foreign currency exchange forward contracts, net investment hedges and interest rate derivative instruments to manage the impact of currency exchange and interest rate fluctuations on earnings and cash flow. At inception the derivative is designated as a cash flow hedge, a fair value hedge or a free standing derivative. We do not enter into derivative instruments for speculative purposes. We did not change our hedging strategies, accounting practices, or objectives from those disclosed in our Annual Report on Form 10-K for 2015.

Designated Net Investment Hedges

We have designated certain long-term intercompany loans payable and forward exchange contracts as net investment hedges of our investments in certain international subsidiaries that use the Euro as their functional currency. The effective portion of derivatives designated as net investment hedges are reported as a component of Accumulated Other Comprehensive Income (AOCI). On June 30, 2016 the total after-tax amount in AOCI related to our designated net investment hedges was \$13. For derivative instruments that are designated and qualify as a net investment hedge, the effective portion of the derivative's gain or loss is recognized in OCI and reported as a component of AOCI.

We use the forward method to measure ineffectiveness. Under this method, for each reporting period the change in the carrying value of the Euro-denominated amounts due to remeasurement of the effective portion is reported as a component of AOCI, and the remaining change in the carrying value of the ineffective portion, if any, is recognized in other income (expense), net. The gain or loss related to settled net investment hedges will be subsequently reclassified into net earnings when the hedged net investment is either sold or substantially liquidated. We evaluate the effectiveness of our net investment hedges quarterly and did not recognize any ineffectiveness in the six months 2016.

Designated and Non-Designated Hedges

June 2016	Designated	Non-Designated	Total
Gross notional amount	\$ 1,011	\$ 2,789	\$3,800
Maximum term in days			546
Fair value:			
Other current assets	\$ 5	\$ 5	\$10
Other noncurrent assets	1	—	1
Other current liabilities	(31) (7) (38
Other noncurrent liabilities	(3) —	(3
Total	\$ (28) \$ (2) \$(30

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December 2015	Designated	Non-Designated	Total
Gross notional amount	\$ 889	\$ 4,061	\$4,950
Maximum term in days			546
Fair value:			
Other current assets	\$ 27	\$ 41	\$68
Other noncurrent assets	1	—	1
Other current liabilities	(6)	(3)	(9)
Other noncurrent liabilities	(1)	—	(1)
Total	\$ 21	\$ 38	\$59

We are exposed to credit loss in the event of nonperformance by our counterparties on our outstanding derivative instruments but do not anticipate nonperformance by any of our counterparties. Should a counterparty default, our maximum exposure to loss is the asset balance of the instrument.

Net Currency Exchange Rate Gains (Losses)

	Three Months	Six Months
Recorded In:	2016	2015
Cost of sales	\$2 \$5	\$8 \$5
Other income (expense), net	(6) (7)	(10) (11)
Total	\$(4) \$(2)	\$(2) \$(6)

On June 30, 2016 and December 31, 2015 pretax (losses) gains on derivatives designated as hedges of (\$22) and \$17, reported in AOCI, were expected to be reclassified to earnings during the next 12 months. This reclassification is primarily due to the sale of inventory that includes previously hedged purchases. There were no ineffective portions of derivatives that resulted in gains or losses in any of the periods presented.

Interest Rate Risk on Future Debt Issuance

In the six months 2016 we terminated multiple designated interest rate cash flow hedges, recognized \$7 in OCI related to hedges on our debt issuances and recognized a nominal amount of ineffectiveness in interest expense. The remaining amounts in AOCI will be reclassified to interest expense over the term of the debt. The cash flow effect of these hedges is recognized in cash flow from operations.

Fair Value Hedges

On June 30, 2016 we had interest rate swaps with gross notional amounts of \$500 designated as fair value hedges of underlying fixed rate obligations representing a portion of our \$600 senior unsecured notes due in 2024. In the six months 2016, there was no hedge ineffectiveness recorded as a result of these fair value hedges.

Fair Value Interest Rate Hedge Instruments

	June 2016	December 2015
Gross notional amount	\$500	\$ 500
Fair value:		
Other noncurrent assets	\$44	\$ 15
Long-term debt	(44)	(15)
Total	\$—	\$ —

NOTE 5 - ACQUISITIONS

In April 2016 we completed the acquisition of Sage Products, LLC (Sage) for total consideration of approximately \$2,875. Sage develops, manufactures and distributes disposable products targeted at reducing "Never Events," primarily in the intensive care unit.

In April 2016 we completed the acquisition of Physio-Control International, Inc. (Physio) for total consideration of approximately \$1,308. Physio develops, manufactures and markets monitors/defibrillators, automated external defibrillators (AEDs) and CPR-assist devices along with data management and support services.

Other acquisitions in 2016 include the April acquisition of Synergetics' neuro portfolio (Synergetics). The acquired portfolio of Synergetics includes the Malis generator, Spetzler Malis disposable forceps, and our existing Sonopet tips and RF generator.

Other acquisitions in 2015 include the acquisition of certain assets of CHG Hospital Beds, Inc. (CHG). CHG designs, manufactures and markets low-height hospital beds and related accessories. The measurement period for CHG is complete. Revisions to the original purchase price allocation were nominal.

These acquisitions enhanced our product offerings within our MedSurg segment. Goodwill acquired with the Sage, Synergetics and CHG acquisitions is deductible for tax purposes.

Supplemental pro forma combined statements of earnings have not been presented for the Sage and Physio acquisitions as the impact of their results of operations were not material to our Consolidated Statements of Earnings.

Purchase Price Allocation of Acquired Net Assets

	2016			2015	
	Sage	Physio	Other	Other	
Purchase price paid	\$2,870	\$1,308	\$225	\$138	
Contingent consideration	5	—	8	9	
Total consideration	\$2,875	\$1,308	\$233	\$147	
Tangible assets acquired:					
Cash	\$91	\$31	\$—	\$—	
Accounts receivable	29	106	5	4	
Inventory	63	72	9	9	
Other assets	80	120	14	17	
Liabilities	(76)	(414)	(18)	(7)	
Intangible assets:					
Customer relationship	948	365	11	12	
Trade name	72	157	13	2	
Developed technology and patents	176	221	90	53	
IPR&D	—	8	7	—	
Goodwill	1,492	642	102	57	
Total	\$2,875	\$1,308	\$233	\$147	
Weighted-average life of intangible assets	15	14	13	10	

Purchase price allocations for acquisitions were based on preliminary valuations and our estimates and assumptions and are subject to change within the measurement period.

Estimated Amortization Expense

Remainder					
of	2017	2018	2019	2020	
2016					
	\$171	\$343	\$336	\$328	\$308

NOTE 6 - CONTINGENCIES AND COMMITMENTS

We are involved in various ongoing proceedings, legal actions and claims arising in the normal course of business, including proceedings related to product, labor, intellectual property and other matters that are more fully described below. The outcomes of these matters will generally not be known for prolonged periods of time. In certain of the legal proceedings, the claimants seek damages as well as other compensatory and equitable relief that could result in the payment of significant claims and settlements and/or the imposition of injunctions or other equitable relief. For legal matters for which management has sufficient information to reasonably estimate our future obligations, a liability representing management's best estimate of the probable loss, or the minimum of the range of probable losses when a best estimate within the range is not known, is recorded. The estimates are based on consultation with legal counsel, previous settlement experience and settlement strategies. If actual outcomes are less favorable than those estimated by management, additional expense may be

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incurred, which could unfavorably affect future operating results. We are self-insured for product liability claims and expenses. The ultimate cost to us with respect to product liability claims could be materially different than the amount of the current estimates and accruals and could have a material adverse effect on our financial position, results of operations and cash flows.

In June 2012 we voluntarily recalled our Rejuvenate and ABG II Modular-Neck hip stems and terminated global distribution of these hip products. Product liability lawsuits relating to this voluntary recall have been filed against us. On November 3, 2014 we announced that we had entered into a settlement agreement to compensate eligible United States patients who had revision surgery to replace their Rejuvenate and/or ABG II Modular-Neck hip stem prior to that date. We continue to offer support for recall-related care and reimburse patients who are not eligible to enroll in the settlement program for testing and treatment services, including any necessary revision surgeries. In addition, some lawsuits will remain and we will continue to defend against them. Based on the information that has been received, the actuarially determined range of probable loss to resolve this matter globally is estimated to be approximately \$1,870 (\$2,102 before \$232 of third-party insurance recoveries) to \$2,411. In the three months 2016 we recognized additional charges to earnings of \$28 representing the excess of the minimum of the range over the previously recorded reserves. We have made a total of \$1,460 of recall-related payments, including \$1,359 under the United States Rejuvenate and ABG II settlement agreement. The final outcome of this matter is dependent on many factors that are difficult to predict including the number of enrollees in the settlement program and the total awards to them, the number and costs of patients not eligible for the settlement program who seek testing and treatment services and require revision surgery and the number and actual costs to resolve the remaining lawsuits. Accordingly, the ultimate cost to resolve this entire matter globally may be materially different than the amount of the current estimate and accruals and could have a material adverse effect on our financial position, results of operations and cash flows. In 2010 we filed a lawsuit in federal court against Zimmer Biomet Holdings, Inc. (Zimmer), alleging that a Zimmer product infringed three of our patents. In 2013 following a jury trial favorable to us, the trial judge entered a judgment that, among other things, awarded us damages of \$76 and ordered Zimmer to pay us enhanced damages. Zimmer appealed this ruling. In December 2014 the Federal Circuit affirmed the damages awarded to us, reversed the order for enhanced damages and remanded the issue of attorney fees to the trial court. The Federal Circuit denied our petition for a rehearing en banc on the issue of enhanced damages. In May 2015 the trial court entered a stipulated judgment that, among other things, required Zimmer to pay us the base amount of damages and interest, while the issues of enhanced damages and attorney fees continue to be pursued. In June 2015 we recorded a \$54 gain, net of legal costs, which was recorded within selling, general and administrative expenses. On June 13, 2016 the United States Supreme Court vacated the decision of the Federal Circuit that reversed our judgment for enhanced damages and remanded the case to the Federal Circuit to reconsider the issue.

In April 2011 Hill-Rom Company, Inc. and affiliated entities (Hill-Rom) brought a lawsuit against us alleging infringement under United States patent laws with respect to nine patents related to electrical network communications for hospital beds. On March 31, 2015 the court granted the parties' joint motion to dismiss with prejudice the claims and counterclaims associated with three of these patents. The case has been stayed with respect to the remaining six patents, until reexamination proceedings at the United States Patent Office have concluded. The ultimate resolution of this

matter cannot be predicted and it is not possible at this time for us to estimate any probable loss or range of probable losses; however, the ultimate result could have a material adverse effect on our financial position, results of operations and cash flows.

NOTE 7 - DEBT AND CREDIT FACILITIES

In March 2016 we sold \$3,500 of senior unsecured notes. Our commercial paper program allows us to have a maximum of \$1,250 in commercial paper outstanding with maturities up to 397 days from the date of issuance. The weighted-average original maturity of the commercial paper outstanding was approximately 40 days. The following table is a summary of our total debt and other debt information.

June	December
2016	2015

Senior unsecured
notes:

Rate	Due		
2.000%	09/30/2016	\$ 750	\$ 749
1.300%	04/01/2018	597	597
2.000%	03/08/2019	745	—
4.375%	01/15/2020	497	496
2.625%	03/15/2021	744	—
3.375%	05/15/2024	636	606
3.375%	11/01/2025	744	744
3.500%	03/15/2026	986	—
4.100%	04/01/2043	391	390
4.375%	05/15/2044	394	394
4.625%	03/15/2046	979	—
Commercial paper		145	—
Other		36	22
Total debt		\$ 7,644	\$ 3,998
Less current maturities		927	768
Total long-term debt		\$ 6,717	\$ 3,230

Unamortized debt
issuance costs \$ 48 \$ 24

Available
borrowing capacity
under all existing
facilities \$ 1,157 \$ 1,236

Fair value of debt \$ 7,881 \$ 4,009

We have lines of credit issued by various financial institutions that are available to fund our day-to-day operating needs. Certain of our credit facilities require us to comply with financial and other covenants. We were in compliance with all covenants on June 30, 2016.

The fair value of debt (excluding the interest rate hedge) was based on the quoted interest rates for similar types and amounts of borrowings. Substantially all of our debt was classified within Level 1 of the fair value hierarchy, because the fair value of the debt was estimated using rates with identical terms and maturities based on quoted active market prices and yields, which took into account the underlying terms of the debt instruments.

On January 1, 2016 we retrospectively adopted ASU 2015-03, Interest - Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs. This standard update requires an entity to present debt issuance costs related to a recognized debt liability as a direct deduction from the carrying amount of that debt liability consistent with the treatment of debt discounts. The adoption of this standard resulted in the reclassification of \$24 of unamortized debt issuance costs principally from other noncurrent assets to a reduction of long term debt on our consolidated balance sheet on December 31, 2015.

NOTE 8 - CAPITAL STOCK

In February 2016 we declared a quarterly dividend of \$0.38 per share payable on April 30, 2016 to shareholders of record at the close of business on March 31, 2016. In April 2016 we declared a

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quarterly dividend of \$0.38 per share payable on July 29, 2016 to shareholders at the close of business on June 30, 2016.

In the six months 2016, 135 thousand shares, repurchased at the end of 2015, were settled at a cost of \$13 under our authorized repurchase programs. The manner, timing and amount of repurchases is determined by management based on an evaluation of market conditions, stock price and other factors and is subject to regulatory considerations. Purchases are made from time-to-time in the open market, in privately negotiated transactions or otherwise. On June 30, 2016 the total dollar value of shares that could be acquired under our authorized repurchase programs was \$1,870. We have suspended our share repurchase program through the remainder of 2016.

NOTE 9 - INCOME TAXES

Our effective tax rates were 12.3% and 2.2% in the three months 2016 and 2015 and 14.5% and 20.8% in the six months 2016 and 2015. The increase in the effective income tax rate in the three months 2016 was due to tax expense related to acquisitions in the quarter, while the effective income tax rate in 2015 included decreased tax expense related to the jurisdictional allocation of tax expense on recall charges. The effective income tax rate in the six months 2016 decreased from 2015 primarily due to certain discrete 2015 tax expense related to the establishment of our European regional headquarters.

NOTE 10 - SEGMENT INFORMATION

The following table is a summary of our results of operations by reportable segments.

	Three Months		Six Months	
	2016	2015	2016	2015
Orthopaedics	\$1,082	\$1,035	\$2,139	\$2,058
MedSurg	1,258	939	2,216	1,866
Neurotechnology and Spine	500	458	980	887
Net sales	\$2,840	\$2,432	\$5,335	\$4,811
Orthopaedics	\$371	\$339	\$720	\$671
MedSurg	253	196	451	376
Neurotechnology and Spine	160	117	299	229
Segment operating income	\$784	\$652	\$1,470	\$1,276
Items not allocated to segments:				
Corporate and other	\$(80)	\$(73)	\$(162)	\$(142)
Acquisition and integration-related charges	(66)	(12)	(71)	(32)
Amortization of purchased intangible assets	(88)	(49)	(141)	(98)
Restructuring-related charges	(22)	(30)	(42)	(56)
Rejuvenate and ABG II recalls	(28)	(112)	(47)	(166)
Legal matters	—	53	12	53
Consolidated operating income	\$500	\$429	\$1,019	\$835

Total assets of our MedSurg segment increased to \$8,916 as a results of our recent acquisitions as discussed in Note 5. There were no other significant changes to total assets by segment from information provided in our Annual Report on Form 10-K for 2015.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

ABOUT STRYKER

Stryker Corporation is a global leader in medical technology with revenues of \$9,946 and net earnings of \$1,439 in 2015. Stryker offers a diverse array of innovative medical technologies including orthopaedic, medical and surgical, and neurotechnology and spine products to help people lead more active and satisfying lives.

We segregate our operations into three reportable business segments: Orthopaedics, MedSurg, and Neurotechnology and Spine. Orthopaedics products consist primarily of implants used in hip and knee joint replacements and trauma and extremities surgeries. MedSurg products include surgical equipment and surgical navigation systems (Instruments), endoscopic and communications systems (Endoscopy), patient handling and emergency medical

equipment (Medical), and reprocessed and remanufactured medical devices (Sustainability) as well as other medical device products used in a variety of medical specialties. Neurotechnology and Spine products include both neurosurgical and neurovascular devices.

Overview of the Three and Six Months

In the three months we achieved sales growth of 16.8% and 17.0% in constant currency, including 10.4% from acquisitions. We reported net earnings per diluted share of \$1.00 in the three months and achieved a 15.8% growth in adjusted net earnings per diluted share.

In the six months we achieved sales growth of 10.9% and 11.6% in constant currency, including 5.3% from acquisitions. We reported net earnings per diluted share of \$2.07 in the six months and achieved a 13.9% growth in adjusted net earnings per diluted share.

A reconciliation of reported net earnings per diluted share to adjusted net earnings per diluted share is included on page 12 of this report.

Recent Developments

In April 2016 we completed the acquisitions of Sage Products, LLC (Sage) for total consideration of approximately \$2,875, Physio-Control International, Inc. (Physio) for total consideration of approximately \$1,308 and Synergetics' neuro portfolio (Synergetics). Sage develops, manufactures and distributes disposable products targeted at reducing "Never Events," primarily in the intensive care unit. Physio develops, manufactures and markets monitors/defibrillators, automated external defibrillators (AEDs) and CPR-assist devices along with data management and support services. The acquired portfolio of Synergetics includes the Malis generator, Spetzler Malis disposable forceps and our existing Sonopet tips and RF generator. Refer to Note 5 in the notes to our Consolidated Financial Statements for further information.

In March 2016 we sold \$3,500 of senior unsecured notes. Refer to Note 7 in the notes to our Consolidated Financial Statements for further information.

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RESULTS OF OPERATIONS

	Three Months					Six Months				
	2016	% Sales	2015	% Sales	% Change	2016	% Sales	2015	% Sales	% Change
Net sales	\$2,840	100.0	\$2,432	100.0	16.8	\$5,335	100.0	\$4,811	100.0	10.9
Gross profit	1,842	64.9	1,605	66.0	14.8	3,536	66.3	3,158	65.6	12.0
Research, development and engineering	183	6.4	154	6.3	18.8	342	6.4	306	6.4	11.8
Selling, general and administrative	1,043	36.7	861	35.4	21.1	1,987	37.2	1,753	36.4	13.3
Recall charges	28	1.0	112	4.6	(75.0)	47	0.9	166	3.5	(71.7)
Intangible amortization	88	3.1	49	2.0	79.6	141	2.6	98	2.0	43.9
Other income (expense), net	(67)	(2.4)	(28)	(1.2)	139.3	(105)	(2.0)	(57)	(1.2)	84.2
Income taxes	53		9		488.9	132		162		(18.5)
Net earnings	\$380	13.4	\$392	16.1	(3.1)	\$782	14.7	\$616	12.8	26.9
Net earnings per diluted share	\$1.00		\$1.03		(2.9)	\$2.07		\$1.61		28.6
Adjusted net earnings per diluted share	\$1.39		\$1.20		15.8	\$2.63		\$2.31		13.9

See "Non-GAAP Financial Measures" on page 12 for a discussion of non-GAAP financial measures used in this report.

Geographic and Segment Net Sales

	Three Months					Six Months				
	2016	2015	Percentage Change	As Reported	Constant Currency	2016	2015	Percentage Change	As Reported	Constant Currency
Geographic:										
United States	\$2,046	\$1,716	19.2%	19.2	%	\$3,868	\$3,389	14.1%	14.1	%
International	794	716	11.0	11.7		1,467	1,422	3.2	5.7	
Total	\$2,840	\$2,432	16.8%	17.0	%	\$5,335	\$4,811	10.9%	11.6	%
Segment:										
Orthopaedics	\$1,082	\$1,035	4.6	4.8	%	\$2,139	\$2,058	3.9	4.7	%
MedSurg	1,258	939	33.8	34.2		2,216	1,866	18.7	19.5	
Neurotechnology and Spine	500	458	9.3	9.0		980	887	10.6	11.0	
Total	\$2,840	\$2,432	16.8%	17.0	%	\$5,335	\$4,811	10.9%	11.6	%

Supplemental Net Sales Growth Information

	Three Months					Six Months				
	2016	2015	Percentage Change	United States	International	2016	2015	Percentage Change	U.S.	International
				Reported	Constant Currency				Reported	Constant Currency
				Reported	Constant Currency				Reported	Constant Currency
Orthopaedics:										
Knees	\$370	\$346	7.1	7.5	%	7.0	%	7.2	8.7	%
Hips	323	320	1.2	1.8		1.2		2.8	639	632
Trauma and Extremities	328	309	6.0	5.6		9.5		0.6	(0.4)	
Other	61	60	1.0	1.4		4.5		(11.6)	(9.7)	

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Total Orthopaedics	\$1,082	\$1,035	4.6	% 4.8	% 5.9	% 2.2	% 2.9	%	\$2,139	\$2,058	3.9	% 4.7	% 6.9	% (1.6)	% 0.7
MedSurg:															
Instruments	\$377	\$354	6.4	% 6.6	% 8.0	% 1.4	% 2.2	%	\$742	\$700	6.0	% 6.7	% 9.1	% (3.5)	% (0.0)
Endoscopy	357	335	6.0	6.4	10.8	(7.7)	(6.1)		685	656	4.3	5.1	9.8	(11.1)	(8.0)
Medical	465	197	136.4	137.2	127.0	174.9	179.5		672	402	67.1	68.1	63.2	83.4	88.0
Sustainability	59	53	11.2	11.2	11.1	46.6	53.6		117	108	8.6	8.6	8.6	15.7	24.0
Total MedSurg	\$1,258	\$939	33.8	% 34.2	% 35.0	% 29.4	% 31.3	%	\$2,216	\$1,866	18.7	% 19.5	% 21.4	% 9.3	% 12.0
Neurotechnology and Spine:															
Neurotechnology	\$312	\$272	14.9	% 14.4	% 15.6	% 13.5	% 12.3	%	\$613	\$524	17.1	% 17.5	% 18.3	% 15.0	% 16.0
Spine	188	186	1.1	1.0	4.8	(8.9)	(9.2)		367	363	1.1	1.5	5.3	(10.4)	(9.0)
Total Neurotechnology and Spine	\$500	\$458	9.3	% 9.0	% 10.9	% 5.9	% 5.0	%	\$980	\$887	10.6	% 11.0	% 12.6	% 6.4	% 7.0
Total Consolidated Net Sales	\$2,840	\$2,432	16.8	% 17.0	% 19.2	% 11.0	% 11.7	%	\$5,335	\$4,811	10.9	% 11.6	% 14.1	% 3.2	% 5.0

Consolidated net sales of \$2,840 increased 16.8% in the three months as reported and 17.0% in constant currency, as foreign currency exchange rates negatively impacted net sales by 0.2%. Excluding the 10.4% impact of acquisitions, net sales in constant currency increased by 7.9% from increased unit volume partially offset by 1.3% due to lower prices. The unit volume increase was

primarily due to higher shipments of knees, medical, endoscopy and trauma and extremities products.

Consolidated net sales of \$5,335 increased 10.9% in the six months as reported and 11.6% in constant currency, as foreign currency exchange rates negatively impacted net sales by 0.7%. Excluding the 5.3% impact of acquisitions, net sales in constant currency increased by 7.7% from increased unit volume partially offset by 1.3% due to lower prices. The unit volume increase was primarily

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due to higher shipments of knees, trauma and extremities, neurotechnology, medical, endoscopy and instruments products.

Orthopaedics Net Sales

Orthopaedics net sales of \$1,082 increased 4.6% in the three months as reported and 4.8% in constant currency, as foreign currency exchange rates negatively impacted net sales by 0.2%. Excluding the 0.3% impact of acquisitions, net sales in constant currency increased by 6.7% from increased unit volume partially offset by 2.2% due to lower prices. The unit volume increase was led primarily by higher shipments of knees and trauma and extremities products. Orthopaedics net sales of \$2,139 increased 3.9% in the six months as reported and 4.7% in constant currency, as foreign currency exchange rates negatively impacted net sales by 0.8%. Excluding the 0.2% impact of acquisitions, net sales in constant currency increased by 6.5% from increased unit volume partially offset by 1.9% due to lower prices. The unit volume increase was led primarily by higher shipments of knees and trauma and extremities products.

MedSurg Net Sales

MedSurg net sales of \$1,258 increased 33.8% in the three months as reported and 34.2% in constant currency, as foreign currency exchange rates negatively impacted net sales by 0.4%. Excluding the 25.7% impact of acquisitions, net sales in constant currency increased by 9.0% from increased unit volume partially offset by 0.5% due to lower prices. The unit volume increase was led primarily by higher shipments of medical and endoscopy products. MedSurg net sales of \$2,216 increased 18.7% in the six months as reported and 19.5% in constant currency, as foreign currency exchange rates negatively impacted net sales by 0.8%. Excluding the 13.0% impact of acquisitions, net sales in constant currency increased by 7.0% from increased unit volume partially offset by 0.6% due to lower prices. The unit volume increase was led primarily by higher shipments of endoscopy, instruments and medical products.

Neurotechnology and Spine Net Sales

Neurotechnology and Spine net sales of \$500 increased 9.3% in the three months as reported and 9.0% in constant currency, as foreign currency exchange rates positively impacted net sales by 0.3%. Excluding the 1.5% impact of acquisitions, net sales in constant currency increased by 8.5% from increased unit volume partially offset by 1.0% due to lower prices. The unit volume increase was led primarily by higher shipments of neurotechnology products.

Neurotechnology and Spine net sales of \$980 increased 10.6% in the six months as reported and 11.0% in constant currency, as foreign currency exchange rates negatively impacted net sales by 0.4%. Excluding the 0.8% impact of acquisitions, net sales in constant currency increased by 11.9% from increased unit volume partially offset by 1.7% due to lower prices. The unit volume increase was led primarily by higher shipments of neurotechnology products.

Gross Profit

Gross profit in the three months decreased to 64.9% of sales from 66.0% in 2015 primarily due to the impact of the sale of inventory stepped up to fair value in connection with our recent acquisitions and unfavorable product mix. The gross profit decrease in the three months was partially offset by the favorable impact of the two-year suspension of the United States medical device excise tax that became effective January 1, 2016. Gross profit in the six months increased to 66.3% from 65.6% in 2015 primarily due to suspension of the United States medical device excise tax. We expect this favorable impact to gross profit as a result of the suspension of the United States medical device excise tax to continue through 2017.

	Three Months			
	2016		2015	
	\$	% Sales	\$	% Sales
Reported Gross Profit	\$1,842	64.9%	\$1,605	66.0%
Inventory stepped up to fair value	35	1.2	6	0.3
Restructuring-related charges	2	0.1	1	—
Adjusted Gross Profit	\$1,879	66.2%	\$1,612	66.3%
	Six Months			
	2016		2015	
	\$		\$	

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	% Sales		% Sales	
Reported Gross Profit	\$3,536	66.3 %	\$3,158	65.6 %
Inventory stepped up to fair value	35	0.6	13	0.4
Restructuring-related charges	5	0.1	2	—
Adjusted Gross Profit	\$3,576	67.0 %	\$3,173	66.0 %

Research, Development and Engineering Expenses

Research, development and engineering expenses increased \$29 or 18.8% to \$183 in the three months and were 6.4% of sales in 2016 compared to 6.3% in 2015. These expenses increased \$36 or 11.8% to \$342 in the six months and 6.4% of sales in both 2016 and 2015. Recent acquisitions and the timing of spending on projects and investments in new technologies contributed to the increased spending levels.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased \$182 or 21.1% in the three months to 36.7% of sales compared to 35.4% in 2015. Excluding the impact of the charges noted below, expenses decreased to 34.9% of sales compared to 36.1% in 2015, primarily due to disciplined expense management, partially offset by the impact of our recent acquisitions, increased compensation costs due in part to sales performance-related compensation and expenses associated with the development of a global enterprise resource planning system.

Selling, general and administrative expenses increased \$234 or 13.3% in the six months to 37.2% of sales compared to 36.4% in 2015. Excluding the impact of the charges noted below, expenses increased slightly to 36.1% of sales compared to 36.0% in 2015, primarily due to increased compensation costs due in part to sales performance-related compensation, the impact of our recent acquisitions and expenses associated with the development of a global enterprise resource planning system.

	Three Months			
	2016		2015	
	\$	% Sales	\$	% Sales
Reported Selling, General and Administrative	\$1,043	36.7 %	\$861	35.4 %
Other acquisition and integration-related	(31)	(1.1)	(6)	(0.2)
Restructuring-related charges	(20)	(0.7)	(29)	(1.2)
Legal Matters	—	—	53	2.1
Adjusted Selling, General and Administrative	\$992	34.9 %	\$879	36.1 %
	Six Months			
	2016		2015	
	\$	% Sales	\$	% Sales
Reported Selling, General and Administrative	\$1,987	37.2 %	\$1,753	36.4 %
Other acquisition and integration-related	(36)	(0.6)	(19)	(0.4)
Restructuring-related charges	(37)	(0.7)	(54)	(1.1)
Legal Matters	12	0.2	53	1.1
Adjusted Selling, General and Administrative	\$1,926	36.1 %	\$1,733	36.0 %

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Recall Charges

Recall charges were \$28 and \$112 in the three months and \$47 and \$166 in the six months of 2016 and 2015. The charges relate to the previously disclosed Rejuvenate and ABG II modular-neck hip stems voluntary recalls. Refer to Note 6 in the notes to our Consolidated Financial Statements for further information.

Intangibles Amortization

Intangibles amortization was \$88 and \$49 in the three months and \$141 and \$98 in the six months of 2016 and 2015. The increases were due primarily to our recent acquisitions. Refer to Note 5 in the notes to our Consolidated Financial Statements for further information.

Other Income (Expense), Net

Other income (expense), net was (\$67) and (\$28) in the three months and (\$105) and (\$57) in the six months 2016 and 2015. The increases were primarily driven by higher interest expense due to higher debt levels as a result of our March 2016 debt offering.

Income Taxes

The effective income tax rate on earnings was 12.3% and 2.2% in the three months 2016 and 2015 and 14.5% and 20.8% in the six months 2016 and 2015. The increase in the effective income tax rate in the three months 2016 was due to tax expense related to acquisitions in the quarter, while the effective income tax rate in the 2015 included decreased tax expense related to the jurisdictional allocation of tax expense on recall charges. The effective income tax rate in the six months 2016 decreased from the effective income 2015 primarily due to certain discrete 2015 tax expense related to the establishment of our European regional headquarters.

Net Earnings

Net earnings decreased to \$380 or \$1.00 per diluted share in the three months from \$392 or \$1.03 per diluted share in 2015. Adjusted net earnings per diluted share increased 15.8% to \$1.39 in the three months from \$1.20 in 2015. In addition, the impact of foreign currency exchange rates on net earnings reduced net earnings per diluted share by approximately \$0.03 and \$0.07 in the three months 2016 and 2015.

Net earnings increased to \$782 or \$2.07 per diluted share in the six months from \$616 or \$1.61 per diluted share in 2015. Adjusted net earnings per diluted share increased 13.9% to \$2.63 in the six months from \$2.31 in 2015. In addition, the impact of foreign currency exchange rates on net earnings reduced net earnings per diluted share by approximately \$0.05 and \$0.13 in the six months 2016 and 2015.

	Three Months			
	2016		2015	
	\$	%	\$	%
	Sales		Sales	
Reported Net Earnings	\$380	13.4 %	\$392	16.1 %
Inventory stepped up to fair value	22	0.8	4	0.2
Other acquisition and integration-related	21	0.7	4	0.2
Amortization of intangible assets	59	2.1	34	1.4
Restructuring-related charges	20	0.7	24	1.0
Rejuvenate and other recall matters	23	0.8	46	1.9
Legal Matters	—	—	(46)	(2.0)
Adjusted Net Earnings	\$525	18.5 %	\$458	18.8 %

	Six Months			
	2016		2015	
	\$	%	\$	%
	Sales		Sales	
Reported Net Earnings	\$782	14.7 %	\$616	12.8 %
Inventory stepped up to fair value	22	0.4	8	0.2
Other acquisition and integration-related	25	0.5	13	0.3
Amortization of intangible assets	98	1.8	69	1.4

Restructuring-related charges	34	0.6	43	0.9
Rejuvenate and other recall matters	39	0.7	95	2.0
Legal Matters	(7	)(0.1)	(46	)(1.0)
Tax matters	—	—	84	1.7
Adjusted Net Earnings	\$993	18.6 %	\$882	18.3 %

NON-GAAP FINANCIAL MEASURES

We supplement the reporting of our financial information determined under accounting principles generally accepted in the United States (GAAP) with certain non-GAAP financial measures including percentage sales growth in constant currency; percentage organic sales growth; adjusted gross profit; cost of sales excluding specified items; adjusted selling, general and administrative expenses; adjusted amortization of purchased intangible assets; adjusted operating income; adjusted effective income tax rate; adjusted net earnings; and adjusted diluted net earnings per share (Diluted EPS). We believe that these non-GAAP measures provide meaningful information to assist investors and shareholders in understanding our financial results and assessing our prospects for future performance. Management believes percentage sales growth in constant currency and the other adjusted measures described above are important indicators of our operations because they exclude items that may not be indicative of or are unrelated to our core operating results and provide a baseline for analyzing trends in our underlying businesses. Management uses these non-GAAP financial measures for reviewing the operating results of reportable business segments and analyzing potential future business trends in connection with our budget process and bases certain management incentive compensation on these non-GAAP financial measures.

To measure percentage sales growth in constant currency we remove the impact of changes in foreign currency exchange rates that affect the comparability and trend of sales. Percentage sales growth in constant currency is calculated by translating current year results at prior year average foreign currency exchange rates. To measure percentage organic sales growth we remove the impact of changes in foreign currency exchange rates and acquisitions that affect the comparability and trend of sales. Percentage organic sales growth is calculated by translating current year results at prior year average foreign currency exchange rates excluding the impact of acquisitions.

To measure earnings performance on a consistent and comparable basis we exclude certain items that affect the comparability of operating results and the trend of earnings. These adjustments are irregular in timing, may not be indicative of our past and future performance and are therefore excluded to allow investors to better understand underlying operating trends. The following are examples of the types of adjustments that may be included in a period:

1. Acquisition and integration-related costs. Costs related to integrating recently acquired businesses and specific costs related to the consummation of the acquisition process.
2. Amortization of purchased intangible assets. Periodic amortization expense related to purchased intangible assets.
3. Restructuring-related charges. Costs associated with focused workforce reductions and other restructuring activities.

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4. Recall matters. Our best estimate of the minimum of the range of probable loss to resolve certain product recalls.

5. Regulatory and legal matters. Our best estimate of the minimum of the range of probable loss to resolve certain regulatory matters and other legal settlements.

6. Tax matters. Certain significant and discrete tax items and adjustments to interest expense related to the settlement of certain tax matters.

Since non-GAAP financial measures are not standardized it may not be possible to compare these financial measures with other companies' non-GAAP financial measures having the same or similar names. These adjusted financial measures should not be considered in isolation or as a substitute for reported sales growth,

gross profit, cost of sales, selling, general and administrative expenses, amortization of purchased intangible assets, operating income, effective income tax rate, net earnings and diluted net earnings per share, the most directly comparable GAAP financial measures. These non-GAAP financial measures are an additional way of viewing aspects of our operations that, when viewed with our GAAP results and the reconciliations to corresponding GAAP financial measures at the end of the discussion of Results of Operations below, provide a more complete understanding of our business. We strongly encourage investors and shareholders to review our consolidated financial statements and publicly-filed reports in their entirety and not to rely on any single financial measure.

Reconciliation of Non-GAAP Financial Measures to the Most Directly Comparable GAAP Financial Measures

		Selling, Gross Profit	General & Administrative Expenses	Intangible Amortization	Operating Income	Net Earnings	Effective Tax Rate	Diluted EPS
Three Months 2016								
Reported		\$ 1,842	\$ 1,043	\$ 88	\$ 500	\$ 380	12.3 %	\$ 1.00
Acquisition and integration related charges:								
Inventory stepped up to fair value	35	—	—	—	35	22	1.6	0.06
Other acquisition and integration related	—	(31	)	—	31	21	1.0	0.06
Amortization of purchased intangible assets	—	—	(88	)	88	59	3.1	0.16
Restructuring-related charges	2	(20	)	—	22	20	(0.4)	0.05
Rejuvenate recall matters	—	—	—	—	28	23	—	0.06
Adjusted		\$ 1,879	\$ 992	\$ —	\$ 704	\$ 525	17.6 %	\$ 1.39
Three Months 2015								
Reported		\$ 1,605	\$ 861	\$ 49	\$ 429	\$ 392	2.2 %	\$ 1.03
Acquisition and integration related charges:								
Inventory stepped up to fair value	6	—	—	—	6	4	0.2	0.01
Other acquisition and integration related	—	(6	)	—	6	4	0.2	0.01
Amortization of purchased intangible assets	—	—	(49	)	49	34	1.7	0.09
Restructuring-related charges	1	(29	)	—	30	24	0.2	0.06
Rejuvenate and other recall matters	—	—	—	—	112	46	11.8	0.12
Legal matters	—	53	—	—	(53	(46	0.5	(0.12)
Adjusted		\$ 1,612	\$ 879	\$ —	\$ 579	\$ 458	16.8 %	\$ 1.20
Six Months 2016								
Reported		\$ 3,536	\$ 1,987	\$ 141	\$ 1,019	\$ 782	14.5 %	\$ 2.07
Acquisition and integration related charges:								

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Inventory stepped up to fair value	35	—	—	35	22	0.7	0.06
Other acquisition and integration related	—	(36) —	36	25	0.5	0.07
Amortization of purchased intangible assets	—	—	(141	) 141	98	2.0	0.26
Restructuring-related charges	5	(37	) —	42	34	0.1	0.09
Rejuvenate recall matters	—	—	—	47	39	—	0.10
Legal matters	—	12	—	(12	)(7	)(0.3	)(0.02
Adjusted	\$3,576	\$ 1,926	\$ —	\$ 1,308	\$ 993	17.5	% \$2.63

	Selling,						
Six Months 2015	Gross Profit	General & Administrative Expenses	Intangible Amortization	Operating Income	Net Earnings	Effective Tax Rate	Diluted EPS
Reported	\$3,158	\$ 1,753	\$ 98	\$ 835	\$ 616	20.8	% \$1.61
Acquisition and integration related charges:							
Inventory stepped up to fair value	13	—	—	13	8	0.3	0.02
Other acquisition and integration related	—	(19	) —	19	13	0.3	0.04
Amortization of purchased intangible assets	—	—	(98	) 98	69	1.4	0.18
Restructuring-related charges	2	(54	) —	56	43	0.4	0.11
Rejuvenate and other recall matters	—	—	—	166	95	5.3	0.25
Legal matters	—	53	—	(53	)(46	) 0.3	(0.12
Tax Matters	—	—	—	—	84	(10.7	) 0.22
Adjusted	\$3,173	\$ 1,733	\$ —	\$ 1,134	\$ 882	18.1	% \$2.31

The weighted-average basic and diluted shares outstanding used in the calculation of these non-GAAP financial measures are the same as those used in the calculation of the reported per share amounts.

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FINANCIAL CONDITION AND LIQUIDITY

	Six Months	
	2016	2015
Net cash provided by operating activities	\$671	\$737
Net cash (used in) provided by investing activities	(3,912)	2,226
Net cash provided by (used in) financing activities	3,342	(1,051)
Effect of exchange rate changes	10	(81)
Change in cash and cash equivalents	\$111	\$1,831

Operating Activities

Cash provided by operations was \$671 and \$737 in the six months 2016 and 2015. Operating cash flows resulted primarily from net earnings adjusted for non-cash items (depreciation and amortization, share-based compensation and deferred income taxes). The decrease was primarily due to recall-related payments associated with the Rejuvenate and ABG II recalls, higher compensation related payments and higher inventory purchases. This was partially offset by lower income tax payments. The net of accounts receivable, inventory and accounts payable resulted in the consumption of \$173 and \$11 of cash in the six months 2016 and 2015. The increase in consumption was due to higher inventory purchases in 2016. Inventory days on hand on June 30, 2016 increased by 14 days from December 31, 2015.

Investing Activities

Cash used in investing activities was \$3,912 for 2016 primarily due to cash paid for acquisitions. Cash provided by investing activities was \$2,226 in 2015 due to the sale of marketable securities in preparation for recall-related payments.

Acquisitions: Acquisitions resulted in cash consumption of \$4,219 and \$92 in the six months 2016 and 2015. In 2016 we acquired Sage, Physio, Synergetics and various other businesses and related assets. In 2015 the primary acquisition was CHG.

Capital Expenditures: Capital expenditures were \$229 and \$114 in the six months 2016 and 2015.

Marketable Securities: Net cash provided by the sale of marketable securities was \$536 and \$2,432 in the six months 2016 and 2015.

Financing Activities

Dividend Payments: Dividends paid per common share were \$0.76 in the six months 2016 and 2015. Total dividend payments to common shareholders were \$284 and \$261 in the six months 2016 and 2015.

Short-Term and Long-Term Debt: Net proceeds from borrowings were \$3,611 in the six months 2016, primarily from the issuance of \$3,500 of senior unsecured notes in March 2016. Net repayments of debt were \$498 in 2015 as we repaid all of our senior unsecured notes that were due on January 15, 2015. Refer to Note 7 in the notes to our Consolidated Financial Statements for further information.

Share Repurchases: Share repurchases were \$13 and \$324 in the six months 2016 and 2015. We have suspended our share repurchase program through the remainder of 2016.

Liquidity

Cash, cash equivalents and marketable securities were \$3,656 and \$4,079 on June 30, 2016 and December 31, 2015. Current assets exceeded current liabilities by \$4,219 and \$4,441 on June 30, 2016 and December 31, 2015. We anticipate being able to support our short-term liquidity and operating needs, including acquisitions and recall-related payments related to the Rejuvenate and ABG II recalls

from a variety of sources including cash from operations, commercial paper and existing credit lines.

We raised funds in the capital markets and may continue to do so from time to time. As a result of the issuance of senior unsecured notes in March of 2016, Moody's downgraded our unsecured note ratings to Baa1 from A3, and Standard & Poor's downgraded our corporate credit and long-term issue-level rating to A from A+ and our short-term rating to A-1 from A-1+. Nevertheless we continue to have strong investment-grade short-term and long-term debt ratings that we believe should enable us to refinance our debt as it becomes due.

We have existing credit facilities should additional funds be required. On June 30, 2016 we had approximately \$1,157 of borrowing capacity available under all of our existing credit facilities.

On June 30, 2016 approximately 62% of our consolidated cash, cash equivalents and marketable securities were held in locations outside the United States compared to 46% on December 31, 2015. Our remaining cash held in locations outside the United States is considered to be indefinitely reinvested. We intend to use this cash to expand operations organically and through acquisitions.

Critical Accounting Policies

There were no changes to our critical accounting policies from those disclosed in our Annual Report on Form 10-K for 2015.

New Accounting Pronouncements Not Yet Adopted

Refer to Note 1 in the notes to our Consolidated Financial Statements for further information.

Guarantees and Other Off-Balance Sheet Arrangements

We do not have guarantees or other off-balance sheet financing arrangements including variable interest entities of a magnitude that we believe could have a material impact on our financial condition or liquidity.

OTHER MATTERS

Legal and Regulatory Matters

As further described in Note 6 to our Consolidated Financial Statements, we recorded additional charges to earnings of \$28 representing the excess of the minimum of the range of probable loss to resolve the Rejuvenate and ABG II recalls over the previously recorded reserves. Based on the information that has been received the actuarially determined range of probable loss to resolve this matter is estimated to be approximately \$1,870 (\$2,102 before \$232 of third-party insurance recoveries) to \$2,411. The final outcome of this matter is dependent on many variables that are difficult to predict. The ultimate cost to entirely resolve this matter may be materially different than the amount of the current estimate and could have a material adverse effect on our financial position, results of operations and cash flows.

FORWARD-LOOKING STATEMENTS

This report contains statements referring to us that are not historical facts and are considered "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements, which are intended to take advantage of the "safe harbor" provisions of the Reform Act, are based on current projections about operations, industry conditions, financial condition and liquidity. Words that identify forward-looking statements include words such as "may," "could," "will," "should," "would," "possible," "plan," "predict," "forecast," "potential," "anticipate," "estimate," "expect," "project," "intend," "believe," "may impact," "on track," and words and terms of similar substance used in connection with any discussion of future operating or financial performance, an acquisition or our businesses. In addition, any

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statements that refer to expectations, projections or other characterizations of future events or circumstances, including any underlying assumptions, are forward-looking statements. These forward-looking statements are not guarantees and are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, actual results could differ materially and adversely from these statements.

Some important factors that could cause our actual results to differ from our expectations in any forward-looking statements include those risks discussed in Item 1A. "Risk Factors" of our Annual Report on Form 10-K for 2015. This Form 10-Q should be read in conjunction with our consolidated financial statements and accompanying notes to our consolidated financial statements in our Annual Report on Form 10-K for 2015.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We consider our greatest potential area of market risk exposure to be exchange rate risk. Quantitative and qualitative disclosures about exchange rate risk are included in the "Other Information" section of Management's Discussion and Analysis of Financial Condition in Item 7 of our Annual Report on Form 10-K for 2015 under the caption "Hedging and Derivative Financial Instruments." There were no material changes from the information provided therein.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

An evaluation of the effectiveness of the design and operation of our disclosure controls and procedures on June 30, 2016 was carried out under the supervision and with the participation of our management including our Chairman and Chief Executive Officer and our Vice President, Chief Financial Officer (the Certifying Officers). Based on that evaluation the Certifying Officers concluded that our disclosure controls and procedures are effective.

Changes in Internal Controls Over Financial Reporting

There was no change to our internal control over financial reporting in the six months 2016 that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) We issued 5,787 shares of our common stock in the three months 2016 as performance incentive awards to certain employees. These shares were not registered under the Securities Act of 1933 based on the conclusion that the awards would not be events of sale within the meaning of Section 2(a)(3) of the Act.

ITEM 6. EXHIBITS

(a)

- 31(i)* Certification of Principal Executive Officer of Stryker Corporation pursuant to Rule 13a-14(a)
- 31(ii)* Certification of Principal Financial Officer of Stryker Corporation pursuant to Rule 13a-14(a)
- 32(i)* Certification by Principal Executive Officer of Stryker Corporation pursuant to 18 U.S.C. Section 1350
- 32(ii)* Certification by Principal Financial Officer of Stryker Corporation pursuant to 18 U.S.C. Section 1350
- 101.INS XBRL Instance Document
- 101.SCH XBRL Schema Document
- 101.CAL XBRL Calculation Linkbase Document
- 101.DEF XBRL Definition Linkbase Document
- 101.LAB XBRL Label Linkbase Document
- 101.PRE XBRL Presentation Linkbase Document
- * Furnished with this Form 10-Q

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

STRYKER CORPORATION

(Registrant)

July 22, 2016 /s/ KEVIN A. LOBO

Date Kevin A. Lobo, Chairman and Chief Executive Officer

July 22, 2016 /s/ GLENN S. BOEHNLEIN

Date Glenn S. Boehnlein, Vice President, Chief Financial Officer

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EXHIBIT INDEX

Exhibit 31	Rule 13a-14(a) Certifications
(i)*	Certification of Principal Executive Officer of Stryker Corporation
(ii)*	Certification of Principal Financial Officer of Stryker Corporation
Exhibit 32	18 U.S.C. Section 1350 Certifications
(i)*	Certification of Principal Executive Officer of Stryker Corporation
(ii)*	Certification of Principal Financial Officer of Stryker Corporation
Exhibit 101	XBRL (Extensible Business Reporting Language) Documents
101.INS	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.DEF	XBRL Definition Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document

* Furnished with this Form 10-Q